

Minutes of February 27, 2002

**FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD**

**Minutes**

**February 27, 2002**

**Room 7C13**

**441 G Street NW**

**Washington, DC 20548**

<b><i>Wednesday, February 27, 2002.....</i></b>	<b><i>1</i></b>
<b>Administrative Matters.....</b>	<b>1</b>
• Attendance.....	1
• New Memorandum of Understanding.....	1
<b>Agenda Topics .....</b>	<b>1</b>
• Consolidated Financial Reporting - Concepts Statement.....	1
• Consolidated Financial Reporting - New Reconciliation Statements .....	2
• National Defense PP&E.....	3
• Disclosures regarding nonaudit services .....	4
• Implementation Guide for Statement of Financing.....	7
• Status Report on Earmarked Funds .....	7
<b>Adjournment.....</b>	<b>9</b>

***Wednesday, February 27, 2002***

**Administrative Matters**

- Attendance

The following members were present: Chairman Mosso, Messrs. Calder, Farrell, Kull, Patton, Reid, and Winter

- New Memorandum of Understanding

The new Memorandum of Understanding was provided to the Board members. Ms. Comes explained that Mr. Anderson of CBO has resigned from the Board. The Board will continue its operations through June 30<sup>th</sup> with seven members and a majority of four will be needed to approve actions.

**Agenda Topics**

- Consolidated Financial Reporting - Concepts Statement

Staff opened the discussion by reviewing the Board's December 2001 actions on the draft exposure draft (ED). Those actions were agreement that the CFR should target the

Minutes of February 27, 2002

external user, that the CFR was a statement of accountability to citizens, and that references to reporting program information and assurances of solvency should be deleted. Staff told Board members that after making those changes, the draft ED had been sent to them for comment. Since the comments were more comprehensive than editorial, staff made many and asked the Board to provide input at the day's meeting.

Board comments and actions were to request that staff:

- change the document title and associated references from "Identifying the Target Audience..." to "Target Audience."
- substitute "clear and complete" for "transparent."
- add a sentence linking Congress to citizens by saying that Congress was the ultimate intermediary for citizens.
- expand discussion on how all the qualitative characteristics (reliability, relevance, consistency, comparability, understandability and timeliness) apply to Federal financial reporting, but that the Board is focusing on understandability and timeliness for the CFR.
- make other minor editorial changes.

After discussing the revised project plan, the Board asked staff to make the requested changes and forward a revised exposure draft by email for Board comments by March 6. After Board comments are in, staff will provide a final printable document for Ballot Draft to the Board by mid-March with the objective of issuing the Exposure Draft by March 31, 2002 for a 90-day comment period.

- Consolidated Financial Reporting - New Reconciliation Statements

The Board reviewed a draft exposure draft (ED) that would set specific standards for the Consolidated Financial Report (CFR). The ED address threes issues: (1) the applying SFFASs to the CFR, (2) exempting the CFR from the requirement to prepare the SBR and SOF, and (3) requiring new CFR information.

*Exempting the CFR from the requirement to prepare the SBR and SOF* – The Board discussed whether the SBR and SOF would be useful to the reader of the CFR. For example, whereas the resources for an agency come from appropriations, the government as a whole is financed by taxes and borrowing. A member asserted that this issue is central to the document: the government runs on cash rather than budgetary resources. The Chairman noted that the SBR in its present form is not useful at the CFR level. The Board agreed to include a question for respondents regarding whether they found this information useful and what they would suggest for the CFR that would be relevant and meaningful to users, and to include language making the decision to exempt the CFR more tentative.

Minutes of February 27, 2002

New statements – The Board discussed alternative cash flow statement illustrations that the FASAB staff and the working group had developed. [The Board had agreed to the format for the proprietary-to-budget reconciliation statement in December.] A member preferred version C in Appendix C. Two other members liked version B because it was easy to understand. The Board decided to include two alternative cash flow statement illustrations in the ED.

In addition, the Board decided:

- to add a question for respondents regarding whether the provision in the ED asserting that SFFASs apply to the CFR unless otherwise provided in a standard;
  - to re-word paragraphs 13 and 15 that require new information to make them less prescriptive;
  - to replace "new information" with "new statements" throughout the ED. A member indicated that it is not clear that the statements being proposed for the CFR are principal statements. The Chairman agreed that this point needed to be clarified since they are principal statements;
  - to emphasize the illustrative nature of the pro forma statements;
  - to use the title "cash flow statement" for the proposed illustrative statement reconciling the budget surplus/deficit to cash, and "cash" rather than "operating cash" as its "bottom line" ;
  - that all footnotes will be in the footnote section of the CFR and those footnotes will apply to all of the statements;
  - to delete paragraph 32;
  - to include examples of the SBR and SOF from OMB's Form and Content guidance;
  - to delete the definition of expenditure in the glossary section; and
  - to make other editorial changes.
- National Defense PP&E

Staff reviewed the decisions made by the Board at the December meeting. They were: 1) treat ND PP&E the same as general PP&E, 2) to allow the use of composite and group allocation methodologies, and 3) eliminate the disclosures on units, condition, and the 10 largest acquisition programs. Staff explained that the draft exposure draft (ED) incorporates these decisions and the objective is to finalize the draft ED for balloting in early March. The schedule is set for a final vote on standards by June 30.

## Minutes of February 27, 2002

One Board member objected to the fast schedule. The Chairman explained that there were two reasons to move quickly to get the vote by June 30. One is that it would be difficult to ask three new board members to vote on this final standard. And second, it is important to give direction to the Department of Defense as they work toward new systems. The Board members agreed to the schedule.

Staff noted that the ED doesn't address cleanup costs so the title should be changed to "Eliminating the Category of National Defense Property, Plant, and Equipment." There was no discussion or objection from the Board members.

One Board member raised the issue of allowing the use of composite depreciation. Some members were concerned that blanket permission could be abused. Others were concerned that proving it was a good approximation to an auditor could be as onerous as depreciating each item separately. One Board member observed that even depreciating individual items is very imprecise. It was agreed that paragraphs 9 and 10 should be eliminated and the use of the composite and group allocation methodologies be included in paragraph 8 of the ED to amend SFFAS No. 6. The Executive Director pointed out that Statement 6 indicates that depreciation should be systematic and rational so this alleviated some of the Board's concerns that composite depreciation could be used in an abusive way and still be GAAP.

Staff focused the Board's attention on paragraph 27, which discusses the disclosures that were required by the previous ED but will not be required by this draft ED. Staff indicated that this paragraph could be expanded to make it more meaningful. The Chairman asked board members to affirm that the special disclosures should not be required. A number of members were interested in some of the disclosures, particularly units. One Board member wanted Selected Acquisitions Report (SARs) type disclosures to be required. The Board decided not to require any of these disclosures now but to say in the Basis for Conclusions that they would be addressed in a future project that would consider the disclosures in proposals applicable to all federal government entities.

Two Board members objected to the tone of the Basis for Conclusions suggesting that it was framed in terms of DOD's positions rather than the merits of the accounting being proposed. The Chairman agreed that the emphasis should be on good accounting.

The Chairman indicated that there needed to be a quick turn around for this document. Staff committed to providing a pre-ballot and then a ballot version quickly.

- Disclosures regarding nonaudit services

At the Chairman's request, staff reviewed SFFAC 1's objective on "systems and control." Staff noted that internal control is a broader concept and concern than internal control relevant to a financial statement audit. AICPA notes that "...policies and procedures concerning the effectiveness, economy, and efficiency of certain management decision-making processes . . . although important to the entity, do not ordinarily relate to a financial statement audit." Internal control relevant to financial

statement audits does, however, encompass concerns about the “control environment” as well as accounting systems and control procedures. Some of the “control environment” factors identified by AICPA include:

1. Management’s philosophy and operating style
2. Organizational structure
3. Functioning of the Board and its committees, particularly the audit committee

GAAS (AU 380) calls for the auditor to communicate with management about certain accounting, auditing, and control issues. The SEC encourages registrants to make similar information available to investors and creditors (See *Cautionary Advice Regarding Disclosure About Critical Accounting Policy*, Dec. 2001 and *Commission Statement about Management’s Discussion and Analysis of Financial Condition and Results of Operations*, Jan. 2002.)

Staff noted that GAO recently amended *Government Auditing Standards* (also known as “the Yellow Book”) by revising the standard on auditor’s independence. The new standard precludes an auditor from performing management functions or auditing his or her own work. The Comptroller General’s press release regarding the standard said:

“... this new standard is the first of several planned steps in connection with nonaudit services covered by the Yellow Book. For example, the Comptroller General plans to work with the Federal Accounting Standards Advisory Board, which develops generally

accepted accounting principles for the federal government, to determine what type of additional disclosures relating to nonaudit services may be appropriate.”

The SEC now requires companies registered with the SEC to disclose separately the amounts they pay for audit and for consulting services. The intent of the SEC’s requirement is to address concerns that the independence of a public accountant might be compromised by large fees for non-audit services.

A member said that the objective of a similar requirement for federal agencies would be for readers of the agencies’ financial statements to have an informed understanding of auditor independence. He noted that auditors do substantial non-audit work for federal agencies. He said that GAO had become more concerned about auditor independence, and had accordingly issued the new independence standard. Similarly, readers of the financial statements need something to give them a more informed perspective on the auditor’s independence.

The Chairman suggested that the FASAB might wish to set a good example. He suggested that FASAB could consider a spectrum of possibilities. It might conclude that

no new standard is needed. If one is needed, it might focus only on potential auditor bias arising from consulting fees, or more broadly on the integrity and clarity of financial reporting, or more broadly still on the full range of objectives of internal control.

A Board member said the Board should move cautiously. He noted that Inspectors General, not agency managers, are responsible for conducting or engaging for audits of agency financial statements. The Inspectors General are independent of agency management by law, he said. Federal agencies need help from consultants. If forced to choose between auditing and more lucrative consulting engagements, his experience suggested to him that firms could walk away from the audit. We should not unnecessarily inhibit agencies from getting help from the best firms. Another member asked whether there was a question about the independence of the Inspectors General.

A member pointed out that federal contracts for audit and consulting services are procured competitively pursuant to federal purchasing regulations, though some are "sole source" contracts. This is very different from what occurs in some corporations. Another member said there could be an appearance of a lack of independence despite the competition. This could reduce the credibility of the financial statements.

It was noted that GAO's new independence standard, as well as changes in the public accounting industry, will limit the extent to which a single firm can provide both audit and consulting services to a given federal agency. Many of the large accounting firms have separated their consulting practice from their auditing practice. He noted that it is often difficult to define what is a nonaudit service. For example, is helping an audit client prepare the Statement of Financing a nonaudit service? Similar questions arise in other areas, such as EDP audit specialists contracted to do penetration testing or other security testing beyond the scope of what is required to audit the financial statements. Standards about such matters may seem easy to write, but can be hard to implement. They can impose a burden on the firms involved. It is hard to know what work a worldwide accounting firm does for a worldwide agency like DOD.

The Board concluded that there is not a clear need for a fee disclosure standard similar to the SEC's requirement because circumstances are different in the federal domain.

The Board then discussed whether FASAB should require management's assertions about internal control to be included as part of the financial report. A member said these assertions are a required part of the Accountability Report, and that OMB's "Form and Content" bulletin will require all reporting entities to submit Accountability Reports. Another member said that federal managers make certain assertions about internal control, and federal audit requirements call for the auditor to report on internal controls. [These requirements are addressed in different ways by different auditors.] Thus, federal financial reporting has more safeguards in place than may be true in the private sector. Nevertheless, it might be useful to include such assertions as part of the audited financial statements that would be generally available. A member asked whether the

objective of such a standard would be to provide information to users, or to induce certain changes in management's behavior. Another member suggested that it might do both. The Board concluded there was no need to require management's assertions about internal control.

The Board then discussed whether FASAB should require disclosures dealing with topics similar to those typically discussed by an auditor with an audit committee (cf. AU 380) or similar to those called for by recent SEC releases. The SEC's guidance is intended to enhance the integrity and clarity of financial reporting. A member said that it was unclear what preparers would say in response to the SEC's guidance. The Board concluded that it would be premature to propose new disclosures based on the SEC's. Private sector experience with the SEC's requirements may indicate what, if any, added requirements would be appropriate in the federal domain.

The Board then discussed whether to require disclosure of the audit firm's tenure. A member noted that federal contracts are for a limited period. The Board concluded that there is no need for such a disclosure requirement.

- Implementation Guide for Statement of Financing

The staff presented a draft guide for preparing the statement of financing. The staff explained that the statement of financing is complex and had proven a challenge to implement. Additional guidance was needed about the concepts underlying the statement and how to prepare it. The guide supercedes paragraphs 72-93 and 122-173 of the *Implementation Guide to Statement of Federal Financing Accounting Standards No. 7*. The staff explained that the guide had been vetted with federal accountants and analysts having specific subject matter expertise. The staff proposed, absent a majority of members' objecting, to publish the guide. A member suggested that the guide be vetted with private auditing firms having expertise with the statement of financing, and the staff indicated that such a review would be obtained before releasing the guide. The Board did not object to staff releasing the guide.

- Status Report on Earmarked Funds

Staff described the work accomplished since the last Board Meeting. The list of earmarked funds was finished; the working group met in January, discussed the different issues and concluded that concentrating on the shortcomings of current requirements would be most fruitful.

Staff explained that at present staff is examining the agency level financial statements to determine disclosure for earmarked funds. A Board member suggested that the term earmarked funds is one that suggests congressional activity and involvement and that we might want to find another term. Staff suggested we use the term in the current standard, Dedicated Collections. A Board member asked if the Indian trust funds were on the list. Staff explained that the tribal trust funds, which are non-revolving trust

## Minutes of February 27, 2002

funds, are on the list, but the individual trust funds are fiduciary, that is they belong to the Indians not the government, and therefore are not on the list. The Board member wondered why, if the money was theirs, the Indians were suing for it. Another Board member explained the federal government administers the funds and the Indians believe that the government has not maintained the accounts properly.

A Board Member said he was more than satisfied with what was on the list but needed more of an understanding of what the list represented. Another Board member said that his understanding was that the funds could be funded through appropriations, taxes, fees, in many different ways and it would be useful to see the flow of cash through the government. It would show how the government works. For example, the Highway funds don't all go for roads. Staff gave an example of how funds lose their identity in the system. The Fund for Strengthening Markets, Income and Supply, which is a special fund administered by the Agricultural Marketing Service of the Department of Agriculture. The source of the funds is a permanent appropriation equal to 30 percent of the gross receipts from duties collected under the customs laws. The Secretary of Agriculture can decide how this money is to be allocated. Most of it is now transferred to the Food and Nutrition Service for the School Lunch Program. The fund per se does not appear in any financial statements. Staff suggested that it might be a good idea to create a graph showing the flow but not for all the different funds.

A Board Member suggested it might be a good idea to show the flow for five or six funds. The question is how to make it clear to the user about all the special funds. Another Board member pointed out that nearly all the funds would appear in the statements but not identified by fund. In most cases the programs associated with the earmarked funds are what is being reported. For example, the Social Security Program is comprised both of the administrative side, which is probably immaterial and the benefit side. The trust fund itself is not shown separately.

Another Board Member stated that we should have guidance for accounting for these funds. One question is who owns the money? The government or the people?

The Chairman said the list should also include the same type of information for fiduciary funds. Then the Board would have to decide if it wanted to explore fiduciary funds. The Board may need to clear up the terminology for financial reporting. A Board Member reiterated that the information needed to be more structured for him to understand. Staff responded that the issues related to earmarked funds have to be examined from several different perspectives. Staff does not yet have sufficient information to provide a totally structured approach. The Board member agreed that a matrix showing the different characteristics might be necessary.

A Board member wondered if once it was determined that a fund is not federal, do we need any more information on it. That is to make headway on the need to structure the project, once we know the funds are not government, should we just set it aside. Another Board member responded that if the money is in the budget it is very clear that it is the government money regardless of source. A visitor to the Board raised the



Minutes of February 27, 2002

United Mine Worker's fund as one that is not appropriated. The Chairman observed that someone has to set up eligibility for that fund.

A Board Member asked if stratification was the next step in the project. Staff indicated that it was mostly accomplished in the earmarked area, but that fiduciary funds had not been similarly addressed. A Board Member asked if the term non-fiduciary was one that is commonly used. Another member said that the term fiduciary was introduced in SFFAS No. 7. The Board visitor explained the difference between the term trust as used by the private sector and as used by the government. We should refer to federal trust funds that are like private sector trust funds as "fiduciary." Board Members suggested characteristics that are used to distinguish different types of funds, such as government owned and shown on the budget, and one member suggested that they provide staff with a list of the characteristics that they consider important. A Board Member said he would like to see those funds which are supposedly "earmarked" but are used for something else, described so that the public can understand.

### **Adjournment**

The meeting adjourned at 3:30.